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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, SEPTEMBER 30, 1985 VOLUME XXII, NUMBER 34

Oil Prices May Stabilize . . .

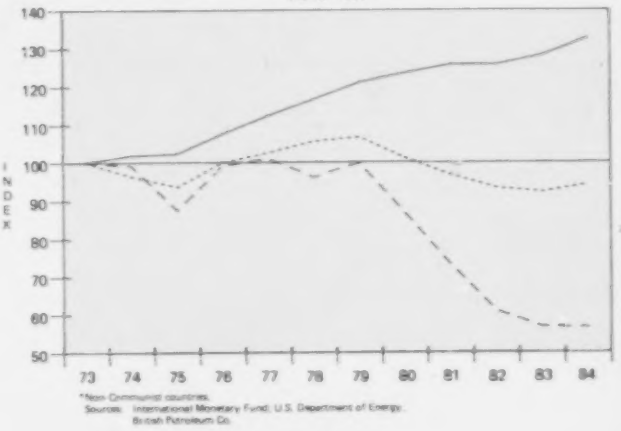
In response to the alarming U.S. merchandise trade deficit and prospects for the enactment of protectionist legislation by Congress, the finance ministers and central bankers of five major industrial countries met last week in New York to discuss both. The immediate result of this meeting was a sharp drop in the external value of the dollar, as market participants anticipated strong official action—some of which indeed did occur—to drive the dollar lower in the foreign exchange markets. And, while it is premature to say whether such actions will be ultimately successful, among the possible side effects of a lower-valued dollar could be stronger economic growth in the United States—but more inflation as well.

The prospects for a pickup in U.S. business activity and a firming of commodity prices will certainly be welcomed by the oil ministers of the Organization of Petroleum Exporting Countries (OPEC). They meet in Vienna this week in order to set oil production quotas for this winter season, and, by so doing, attempt to head off further oil-price weakness. In the near term, oil prices are expected to remain fairly stable, at least through the winter months. For despite some signs of internal OPEC disunity with respect to quotas—which might lead to excess production and thus lower prices—a number of other factors suggest that this event may not materialize.

Perhaps the principal reason for expecting lower oil prices in the near term is the likelihood of a surge in Saudi Arabian oil output. It appears that Saudi Arabia is increasingly willing to abandon its role as OPEC's swing producer and defender of oil prices, if only to discipline other OPEC members that have been producing oil at a rate above their assigned limits. For Saudi Arabia, the role of swing producer has become an increasingly onerous financial burden. Although it conferred upon the country a preeminent position within OPEC and a greater control over prices, it has also saddled the country with the responsibility of periodic and sometimes drastic production cutbacks in times of easing world oil demand, rising non-OPEC oil production or deliberately excessive oil liftings by one or another OPEC producer beyond its quota allocation.

As a result, the kingdom's oil output has shrunk nearly 80 percent in recent years, from ten million barrels per day (MBPD) in 1981 to as low as 2.2 MBPD recently. At this rate of output, which is about half its current quota of 4.35 MBPD, the country is not generating enough dollars to pay for already declining imports. Consequently, its balance of trade in goods and services appears headed for yet another $20 billion deficit this year after shortfalls of a similar magnitude in the preceding two years.

TRENDS IN WORLD* GNP (LINE), WORLD OIL CONSUMPTION (DOT), AND OPEC OIL PRODUCTION (DASH)
(1973=100)



*Non-Communist countries.
Sources: International Monetary Fund, U.S. Department of Energy, British Petroleum Co.

. . . In The Winter Months . . .

Responding to financial pressures, Saudi Arabia is beginning to act less as the leader of a price-fixing cartel than as an economic entity more willing to barter, discount and deal in accordance with market forces. Apparently taking effect on October 1, Saudi Arabia has announced that it will increase oil output by one million barrels per day, much of which is to be sold to three American companies at prices reflecting those of the refined products that will be produced. That would imply a discount of $2 to $3 from official prices. What is more, the country will price output freely in the future, although limiting production to within its quota. All in all, the increase in the oil output—and in the world oil supply—could amount to two million barrels per day should Saudi Arabia push production to the limit of its current quota.

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Such an increase is, however, expected to be readily absorbed by the world market over the next six months. For one thing, world demand increases during the cold season in the Northern Hemisphere, which alone could take up about 1.5 MBPD of the new supply under normal winter conditions. For another, some part of the new supply may be diverted to the rebuilding of depleted crude oil inventories, which are calculated to be at near record lows. Finally, a shortfall in Soviet oil output in the first eight months of this year, amounting to more than 450,000 barrels per day below a year ago, may translate into a source of new demand for Mideast oil. For all these reasons, and barring any significant increases in output from other sources within or outside of OPEC, oil prices should be fairly stable in the near term.

. . . Only To Decline Afterwards

Beyond the winter season, world demand for oil may also get a boost from the effort of the five major industrial countries to dampen the external value of the dollar. A lower dollar would make oil cheaper for the rest of the world in terms of their local currencies, since oil imports are paid for in dollars. The lower local currency price should raise the demand for oil by slowing the substitution of other fuels for it. It may also stimulate an increase in economic growth in these countries which will, in turn, translate into some rise in demand for oil. Finally, if the lower value of the dollar also improves economic performance in the United States, by making this country more competitive in world markets, U.S. demand for oil may also increase.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	9/25/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	181.744	+ 2.928	+16.914
Loans to Depository Inst.	1.262	+ .183	– 5.634
Float	.464	+ .072	+ .577
Total Reserve Bank Credit	196.322	+ 3.358	+15.372
Treasury Deposits with Federal Reserve Banks	6.601	+ 3.247	– 1.809
Currency in Circulation	187.532	– 1.150	+12.150
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	128.042	– 1.088	+12.206
	9/25/85		
Member Bank Reserves:			
Total Reserves Held	43.034	– .090	+ 5.352
Excess (Deficiency)	.561	– .123	+ .034
Net Free Reserves	.046	+ .085	+ .260

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (9/16/85)	610.4	+ 15.4‡	+ 10.8‡
M2 (August '85)	2,513.8	+ 11.3	+ 9.6
M3 (August '85)	3,136.0	+ 7.8	+ 8.9
Domestic Nonfinancial Debt (2nd Q'85)	6,317.3	+ 12.2	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 9/27/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.00%	7.05%	7.42%
* Federal Agencies	7.93	8.12	8.02
* Municipal Notes—High Grade (46% Taxable Equivalent)	9.24	9.49	9.92
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.70	7.90	8.20

‡ Finance Company Paper—Prime	
5- 14 days	7.70%
15- 29 days	7.65
30- 59 days	7.65
60- 89 days	7.65
90-179 days	7.65
180-239 days	7.60
240-270 days	7.60

‡* Bankers' Acceptances	
Oct.	7.80%
Nov.	7.80
Dec.	7.80
Jan.	7.80
Feb.	7.80
Mar.	7.75

‡ Industrial Paper—Prime	
30- 89 days	7.65%
90-120 days	7.65

†Federal Funds Effective Rate 7.88%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85	$ 3,853	$ 3,811	$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85	$ 1,671	$ 1,664	$ 1,639
Percent Change, Annual Rate	2nd Q'85	1.9	0.3	7.1
Change in Consumer Prices*	Aug '85n	2.4%	2.4%	4.8%
Change in Producer Prices*	Aug '85	– 3.6%	3.6%	– 2.4%
Civilian Employment (Thousands of Persons)†	Aug '85	107,172	106,862	105,148
Unemployment as % of Civilian Labor Force†	Aug '85	7.0%	7.3%	7.5%
Personal Income*	Aug '85	$ 3,199	$ 3,190	$ 3,046
Leading Indicators Composite Index (1967=100)†	Jul '85	168.7	168.0	163.9
Industrial Production Index (1977=100) †	Aug '85	124.8	124.4	123.5
Net Change in Consumer Installment Credit †	Jul '85	$ 6.25	$ 5.23	$ 6.48
U.S. Merchandise Trade Balance †	Aug '85n	–$ 9.90	–$ 10.51	–$ 10.09
Plant and Equipment Expenditures*	4th Q'85	$387.40(a)	$389.54(a)	$368.29
Private Housing Starts (Thousands of Units)*	Aug '85	1,749	1,647	1,590
New Construction Expenditures*	Jul '85	$ 349.5	$ 345.4	$ 319.1
Total Business Inventories †	Jul '85	$ 579.8	$ 579.7	$ 557.2
Total Business Sales †	Jul '85	$ 422.2	$ 418.4	$ 412.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

Nevertheless, the longer-term outlook for the price of oil appears downward. Non-OPEC oil supplies, which now account for approximately 70 percent of global supplies compared with some 55 percent just five years ago, continue to rise with the rate of increase averaging one MBPD in the last two years. New supplies will come in part from such developing countries as India, Colombia and Egypt, all of which will either substitute domestic output for foreign oil supplies, or seek to export oil beyond their domestic needs in order to earn much-needed foreign exchange. The shrinking role of OPEC as a supplier of the world's oil needs should diminish the organization's ability to hold the line on world oil prices.

So, too, ongoing energy conservation and substitution of coal and other energy sources for oil, will dampen the rise in demand for oil even as world economic activity continues to expand (see chart on page 1). These alternative fuels now account for a shade more than 60 percent of the world's energy needs, up from 53.6 percent in 1973. In particular, coal's share has risen to over 30 percent currently from 28.4 percent in 1973, while that for natural gas has correspondingly edged up to nearly 20 percent from 18.3 percent. Because of the increasing importance of these other fuels, the world's consumption of oil, at less than 59 MBPD in 1984, was lower than the amount consumed in 1976. To be sure, as oil prices slide, conservation and substitution efforts may be de-emphasized, and in some cases abandoned; while this could put a brake on the decline in prices, it will not halt it entirely. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (9/11/85)	156,357	+ 1,257	– 622
New York City (9/18/85)	32,404	– 221	– 2,909
Commercial Paper (9/18/85)	276,163	+ 2,832	+49,598

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

	Latest Week	Change Since Week Ago	Change Since Year Ago
Weekly Reporting Large Commercial Banks			
Nationwide (9/11/85)	252,765	– 792	+ 8,384
New York City (9/18/85)	60,836	+ 500	– 4,538

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/11/85)	687,594	– 2,371	+ 63,391
New York City (9/18/85)	154,299	+ 2,088	+ 12,907

Financial Markets

	Friday 9/27/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.27%	+ .06	– 3.32
180-Day Bills†	7.40	– .23	– 3.59
Longest Bills†	7.95	– .08	– 3.35
Recent Issues:			
9s 9/30/87	8.76	– .25	
9⅝s 6/30/89	9.42	– .18	
10½s 8/15/95	10.22	– .12	
10⅝s 8/15/15	10.50	– .07	
Municipals:			
Bond Buyer–20 Bond Index* (9/25/85)	9.38%	+ .03	– .77
Blue List Total ($ Million) (9/20/85)	$1,958	+ $ 84	+ $ 395
30-Day Visible Supply ($ Million) (9/20/85)	$3,786	– $945	+ $ 72
Total (9/20/85)	$5,744	– $861	+ $ 467
Corporates:			
Moody's Aa Composite (9/25/85)	11.49%	– .02	– 1.75
30-Day Visible Supply ($ Million) (9/20/85)	$2,978	+ $593	+ $1,683
Stocks:			
Dow-Jones Averages: (9/26/85)			
Industrials	1,320.79	+ 14.00	+ 104.03
Transportation	643.61	– 10.42	+ 124.17
Utilities	150.08	– 3.64	+ 11.69
65 Stocks	535.63	– .93	+ 59.20
Standard and Poor's 500 Stocks	181.29	– 2.10	+ 14.33
N.Y.S.E. Composite Index	104.82	– 1.18	+ 8.63
N.Y.S.E. Avg. Daily Vol. for Week (000's)	100,220	+ 2,864	+ 13,938

* 46% Taxable equivalent 17.37%.

† Bond equivalent.

International Rates

	Friday 9/27/85	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	7.50%	7.88%
1 month	7.81	8.06
3 month	7.94	8.13
6 month	8.06	8.38
1 year	8.25	8.75
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.01%	10.27%
Long Term (7 to 15 yrs.)	10.52	10.68

FOREIGN EXCHANGE SPOT RATES

New York Opening (9/27/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01851	54.0300
Canada	.7345	1.3614
Denmark	.1032	9.6875
France	.1230	8.1300
Germany	.3745	2.6700
Italy	.0005549	1802.00
Japan	.004571	218.75
Mexico	.002670	374.50
Netherlands	.3328	3.0045
Switzerland	.4571	2.1875
U.K.	1.4075	.7105

15th Century: Lorenzo de Medici and his family lead the cultural flowering of Florence.

1508: Pope Julius II commissions Michelangelo to paint the Sistine ceiling.

1717: George I is honored by the composition of Handel's *Water Music*.

18th Century: Thomas Jefferson becomes a noted patron of the arts.

1829: James Smithson of London bequeaths his fortune to the U.S. to establish a museum.

1892: Andrew Carnegie provides the funds to build Carnegie Hall.

Manufacturers Hanover is pleased to carry on the tradition of private sponsorship of the arts for the benefit of the public.

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Among the recent events which Manufacturers Hanover helped make possible: *The Vatican Collections: The Papacy and Art*, Metropolitan Museum of Art, Spring 1984; *Van Gogh in Arles*, Metropolitan Museum of Art, Fall 1984; *Treasures from The New York Public Library*, Spring 1985. Two ongoing programs for which we provide support are the American Ballet Theater and the subtitle program of the New York City Opera.

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